

**EXHIBIT 2**  
**PUBLIC VERSION**



5. I am personally qualified to perform this work. I have a Bachelor of Science Degree in Mechanical Engineering and a Master of Business Administration Degree in Management Science and Labor Relations, both from Lehigh University. I took graduate courses in accounting and auditing at the University of Chicago, Graduate School of Business. I became a CPA in 1981. I am also a Certified Fraud Examiner (CFE) and a Certified Government Financial Manager (CGFM). To maintain these certifications, I obtain approximately 75-100 hours per year of continuing professional education. Since 1995, I have lectured frequently at national and state conferences on accounting, auditing, and fraud topics. I have authored or co-authored 20 articles and publications on audit, accounting, and fraud topics, including *Management Override of Internal Controls: The Achilles Heel of Fraud Prevention* and *Managing the Business Risk of Fraud; A Practical Guide*, both published jointly by the American Institute of CPAs, the Association of Certified Fraud Examiners, and the Institute of Internal Auditors. I currently teach a course titled *Fraud Examination and Forensic Accounting* for The George Washington University's Masters of Accountancy program. I have served on numerous boards and committees and served on the Advisory Council for Government Auditing Standards (ACGAS) from 2006 to 2009. ACGAS advises the Comptroller General of the United States on promulgation of Government Auditing Standards. I have testified as an expert in accounting, auditing, or fraud matters more than 20 times before the United States Court of Federal Claims and other judicial and adjudicative bodies.
6. During my 22-year relationship with the State Department OIG, neither the State Department nor the OIG has ever rejected, contested, or deemed unreliable any audit or consulting report issued by Cotton & Company. To the contrary, the OIG continues to

- retain Cotton & Company to perform audit and consulting tasks related to issues of concern to the State Department.
7. In January 2008, the OIG asked Cotton & Company to submit a proposal to perform an audit of the WPPS II contractor known as Blackwater. We did so, and were awarded a task order to perform that work.
  8. On March 26, 2008, we began the audit by meeting with Justine Sincavage, Director, Office of Overseas Protective Operations and her colleagues. On April 7, 2008, Ms. Sincavage sent us a letter asking that we, among other things, (1) evaluate and assess contractor compliance with contract terms and conditions, applicable laws, rules, and regulations and (2) evaluate and assess the contractor's internal controls related to the contract. This letter is attached as Exhibit A.
  9. Cotton & Company spent 3,194 hours evaluating and assessing whether Blackwater complied with the laws, rules, regulations, and contract terms, and whether Blackwater's internal controls sufficed to ensure that the State Department was being correctly billed under WPPS II Task Order No. 6 (Baghdad). Based on our work, we determined that, due to significant deficiencies in Blackwater's internal accounting controls, it was not possible to conclude that the State Department was being correctly billed by Blackwater.
  10. In December 2008, we prepared and circulated a draft report entitled "Independent Auditor's Report on Financial and Compliance Audit of U. S. Department of State Worldwide Protective Services II, Contract No. S-AQM-PD-05-D-1098, Task Order No. 0006-Iraq S-AQM-PD-06-FB-120 April 4, 2006 to March 31, 2008." This draft report is attached as Exhibit B. We circulated the draft to the State Department and Blackwater personnel.

11. For the next several months, we received and considered comments from Blackwater.

After studying and considering Blackwater's comments, we issued a final report on August 20, 2008, titled "Independent Accountant's Report on Examination of Worldwide Personal Protective Services II Contract No. S-AQM-PD-05-D-1098 Task Order No. 0006-Iraq S-AQM-PD-06-FB-120, May 8, 2006 to March 31, 2008." In this report, we noted and responded to Blackwater's various arguments that the company had no obligation to maintain time and attendance records authenticated by its independent contractors to support labor billings. Blackwater executives argued that the company was not obliged by the terms of the contract to maintain time and attendance records to support the labor invoices (i.e. musters).

12. We were not persuaded that these arguments had merit. Government contractors are required to maintain proper and sufficient documentation to support all billings, including labor billings. Without independently and contemporaneously-prepared time and attendance records authenticated by personnel performing the services, a contractor would be free to overbill for services, without detection.

13. We first reported the recordkeeping deficiencies related to labor costs in our status report dated July 4, 2008. That report was sent to the following DOS personnel: Bohac, Schaeffer, Sincavage, Brown, Werner, Isaac, DeVilla, Van Dessel, Moneypenny, and Cheverini. The labor recordkeeping deficiencies were repeated in bi-weekly status reports issued to these personnel during the remainder of our fieldwork. Those reports were dated July 18, 2008, August 1, 2008, August 15, 2008, and August 29, 2008. At no time did any State Department official express any disagreement with or other concerns about these matters that we were reporting.

14. On July 8, 2009, we convened an exit conference at the State Department offices located at 1701 N. Myer Drive in Arlington, Virginia, to discuss the final report. As reflected in the memorandum attached as Exhibit C, the purpose of the exit conference was to provide both State Department and Blackwater an opportunity to raise any issues or concerns with the content of the draft report.
15. The State Department officials attending the conference (including Messrs. Bohac and Isaac) did not express any objections or disagreements with the draft report during the exit conference. They did not weigh in with support for Blackwater's argument that the company had no obligation to maintain time and attendance records. Had they done so, we would have discussed the issue, and maintained a record of those discussions in our workpapers.
16. The final audit report included a discussion of whether or not the Contracting Officer ("CO") gave Blackwater permission to forgo an adequate time-keeping system. Blackwater had argued that an A/LM/AQM letter dated November 9, 2006, gave them permission to dispense with any timekeeping. We reviewed that letter, as well as the preceding correspondence. Based on our review, we concluded "We believe that the context of the discussion regarding time cards *makes it clear that the CO was not agreeing that Blackwater was not required to prepare and maintain an adequate time-and-attendance system.*" See Exhibit D at 10 (emphasis added).
17. Had the State Department CO or any other State Department official disagreed with that conclusion, and asserted that he or she had given Blackwater permission to dispense with contemporaneous timekeeping records, authenticated by personnel performing the work, we would have analyzed the significance and impact of any such permission, and documented the analysis in our workpapers and included that analysis in the report. Had

any State Department official asserted that he or she had given Blackwater permission to dispense with underlying records essential to verifying the accuracy of costs being claimed under the contract, we also would have referred this to the OIG for investigation.

18. Thereafter, on August 20, 2009, we sent to OIG (J. Jones) and DS/OPO (M. Bohac) the final report. See Exhibit D. The State Department OIG and DS/OPO both accepted Cotton & Company's final report without raising any questions or requesting any modifications whatsoever. Subsequent to the receipt of the final report, the State Department paid our final invoice, which brought the total paid for the examination to \$296,021.
19. I have been provided with the declarations filed in this litigation by Messrs. Bohac and Isaac. Mr. Isaac admitted he did not read the report, but claims he "questioned" and "did not accept" our findings regarding insufficient timekeeping records and labor cost discrepancies. Mr. Bohac testified in his deposition that he could not recall the report, but in his declaration claims he "disagreed" with our conclusions regarding labor overbillings, and "did not accept" our conclusions regarding insufficient timekeeping and labor cost discrepancies.
20. The arguments being expressed, to my knowledge for the first time in this litigation, by Messrs Bohac and Isaac are identical in substance to Blackwater's arguments, which Mr. Roitz and others from Blackwater expressed during the audit process.
21. Had Messrs. Bohac and Isaac expressed these views during the audit process, we would have ascertained whether the CO shared their views. Mr. Isaac was the COR, and Mr. Bohac was an ACOR. Neither served as the CO. If the CO shared their views, we would have analyzed the contract terms, regulations and law to ascertain whether the CO has the power to lift a timekeeping requirement that is uniformly imposed on government

contractors to assure the United States does not overpay for labor. We would have included this analysis in our report and referred the matter to the OIG for further investigation.

22. Although Messrs. Bohac and Isaac now claim that they personally “questioned” or “did not accept” the Cotton & Company report recommendation regarding Blackwater’s need to collect and maintain contemporaneous timekeeping records, the OIG audits (both ours and the others described below) compelled Blackwater to put in place a timekeeping system called the Uni-Time Timekeeping Hand System. See Exhibit E for a description of the system. See Exhibit F, in which Mr. Jackson states, in the context of preparing a bid to obtain another State Department contract:

23. Beginning in 2005 and persisting until corrected, other auditors deployed by the OIG to review Blackwater’s internal processes criticized Blackwater for failing to maintain adequate supporting documentation for labor charges as is required by the Federal Acquisition Regulation.

24. Prior to our audit, the OIG had retained another auditor, Leonard G. Birnbaum & Company, to conduct an agreed-upon procedures review of Blackwater’s accounting system and timekeeping procedures, among other objectives. The Birnbaum firm reviewed Blackwater’s WPPS I records during the time period October 22 to November 20, 2004, and issued a report dated January 7, 2005 entitled “Independent Accountant’s Report.” The Birnbaum Report is attached as Exhibit G. That OIG audit report concluded “[o]ur review disclosed the contractor’s timekeeping procedures in Iraq are



lacking significant internal controls to ensure both accurate recordation of labor costs on this contract and billings to the government as detailed below.” *See* Birnbaum Report at Exhibit G at Appendix 1, page 1 of 2. The Report recommended “that the contracting officer require Blackwater Security Consultants, Inc. to correct the deficiencies noted in Appendices 1 and 2 related to its timekeeping procedures and accounting system.” *See* Birnbaum Report, Summary.

25. Blackwater, in bidding for WPPS II, made a presentation in which it affirmatively represented that it had put in place adequate timekeeping for the contract. *See* Exhibit H at page 71, referring to timesheet and labor distribution components of the Deltek Cost Point system, and page 72, referring to time and attendance information to track all Blackwater staff via the BEARS system.
26. Wholly apart from our audit work, the OIG also worked with the Special Inspector General for Iraq Reconstruction (“SIGAR”) to audit the State Department itself. The State Department was spending more than \$1 billion on Blackwater’s services, and the joint audit was designed to answer four questions. The OIG handled the fourth question: “How did the Department administer the contract and task orders to provide proper oversight of Blackwater’s cost and performance in Iraq?” These entities issued a joint report that echoed our concerns and directly and criticized A/LM/AQM for, among other things, failing to review properly Blackwater’s travel and labor billings. This report (“SIGAR/OIG Report”) is attached as Exhibit I.
27. The SIGAR/OIG Report found that “[a]lthough DS headquarters reviews the muster sheets to determine whether the labor category pay rates used are correct and verifies the mathematical accuracy of the calculations, DS does not verify, at the source of the inputs

in the field, that individuals listed on the muster sheets were in country and on duty for the time periods billed.” *See* SIGAR/OIG Report at 32.

28. The SIGAR/OIG Report found that “[b]ecause DS did not establish and perform measures to verify that information was input into the muster sheets at its source in the field, there is no assurance that personnel staffing data was accurate or complete and that correct labor rates were paid.” *See* SIGAR/OIG Report at 32.
29. SIGAR/OIG recommended that A/OLM and DS/OPO (i.e. Messrs. Bohac and Isaac and their colleagues) “designate a full-time contracting officer’s representative on-site in Baghdad and Hillah, Iraq, to perform, among other contract-related duties, a monthly verification of labor cost data entered at those locations based on observations and tests made in the field.” *See* SIGAR/OIG Report at 33.
30. The SIGAR/OIG audit also found that Blackwater was overbilling for travel, and that State Department did not have enough staff to review the travel invoices: “A DS official said that unallowable travel costs were paid because DS did not have adequate voucher review staff to identify and prevent overbillings.” *See* SIGAR/OIG Report at 36.  
  
SIGAR/OIG recommended that State Department collect overbillings of \$70,907 and review whether additional unallowable travel costs have been paid. *See* SIGAR/OIG Report at 37.
31. Notably, the OIG/SIGAR report -- issued in June 2009 after we concluded our work but before we provided OIG our final report on August 20, 2009 -- echoes many of my concerns and reaches the unqualified conclusion that there was nothing being done by A/LM/AQM or DS/OPO to prevent Blackwater from overbilling the federal government. If the OIG disagreed with or questioned my report, the OIG would not have reached the very same substantive conclusions in the published OIG/SIGAR report.

32. On or about November 16, 2007, DS/OPO officials -- including but not limited to Messrs. Bohac and Isaac -- received an email in which Blackwater's Deputy Project Manager, Chris Story, asserted that Blackwater

*See Exhibit J*

(email produced in litigation).

33. Messrs. Bohac and Isaac and their colleagues at DS/OPO withheld this email from me.

Had I known that the deputy project manager located in Baghdad, Iraq in November 2007 was alleging Blackwater intentionally overbilled the federal government, I would have interviewed him and performed additional procedures to ascertain the impact of these assertions on our examination, and I would have referred this to the OIG for further investigation.

34. Further, State Department officials (including Bohac and Isaac) have admitted during this litigation that they knew that Blackwater travel records were not contemporaneously created, but rather were created well after the travel had occurred. They did not share this information with us during our examination. After we advised Blackwater of the significant discrepancies between the PERSTATs and Musters, Blackwater urged us to use travel records as a means to validate the labor costs. We did not do so for several reasons. There was no documentary evidence that Blackwater had used the travel records to make changes to the Musters; tracing the absence or presence of personnel via travel records would have been an inordinately time-consuming records reconstruction process; and Blackwater was doing other work in Iraq, so that even if we had reconstructed the presence of personnel using travel records, that would have provided no assurance that

those personnel were working on the task order we were examining rather than Blackwater's other work in Iraq.

35. I have recently learned that Blackwater executives withheld critical information from me and my auditors, and made a series of verbal and written misrepresentations to me and my team.
36. As part of our standard procedures, we interviewed key Blackwater executives and asked whether they were aware of any actual, alleged, or potential fraud. All of the Blackwater executives interviewed made verbal misrepresentations during the interviews.
37. They failed to reveal that the company feared fraud or potential fraud in the Amman Jordan operations. They failed to reveal that the company had engaged their private auditor BDO Seidman to investigate the Amman Jordan operations. They failed to provide to us the written report issued by BDO Seidman, which flags a series of questionable practices that impact directly on State Department billings.
38. The email traffic produced in this litigation makes clear that Ms. Esposito and Mr. Taylor were aware of the BDO Seidman report on the forensic investigation of the Amman operation, contemplated providing my audit team that report, but decided not to do so. See Exhibit K (email with draft BDO Seidman report). Had my team and I been permitted to review this report, it would have impacted our examination and analysis.
39. The company executives we interviewed failed to reveal that they had been alerted that Blackwater employees had reported that bribes were being paid to foreign officials. See Exhibit L (testimony of CFO Taylor describing his concerns about bribes). They failed to provide us the written investigative report that investigated payments to foreign officials. See Exhibit L (testimony from CFO Taylor describing the report). Had my

team and I known of the bribery concerns, it would have impacted our examination and analysis.


40. The company executives we interviewed failed to reveal that the company sent a team of employees to Amman Jordan to generate travel records based on the labor musters submitted to the State Department, as well as other documents. See Exhibit M (deposition testimony from company employees about trip). The company executives did not reveal the company's direct involvement in the generation of the travel documents when they were urging us to review the documents as "validation" of the labor costs we questioned. Had my team and I known of the creation of travel records, it would have impacted our examination and analysis.
41. At our request, the company executives executed formal management representation letters. These letters contain a series of incomplete, inaccurate, and misleading statements affirming that management is unaware of any actual, alleged, or potential fraud except as described in the letters. See Exhibit N (representation letters).
42. Although I intend to use my report during my testimony, and I believe my report and other documents prepared by my audit team will assist the jury in understanding the events here, I am not planning to testify that my report accurately sets out all of Blackwater's unsupported costs, control deficiencies, or noncompliance. Although the report is critical of Blackwater, and concludes that the State Department should seek repayment of labor costs that lack essential supporting documentation, the report cannot be relied upon with respect to costs not questioned or set-aside and should no longer be considered to contain all pertinent findings with respect to internal control and compliance. Blackwater and State Department officials withheld critical information that

would have directly impacted the procedures we were performing as part of our examination and that would have been included in our examination report.

43. I am consulting with my attorneys and experts on professional standards regarding the newly discovered information related to fraud and information withheld by Blackwater that would have impacted our examination and we are drafting a follow-up communication to be sent to report users advising them of these newly discovered matters and their impact on our report.

I hereby affirm, under penalty of perjury, that the foregoing is accurate and based on my personal knowledge.

Signed on July 7, 2011.



David L. Cotton, CPA, CFE, CGFM

- A: Sincavage Letter 4-7-2008
- B: Draft audit report December 2008
- C: Exit conference summary
- D: Final audit report
- E: Description of Unitime system
- F: Jackson email about Unitime system
- G: Birnbaum report
- H: Blackwater presentation referring to timekeeping
- I: OIG/SIGAR Report
- J: Chris Story email
- K: Email with draft BDO report
- L: Taylor testimony describing bribe investigations
- M: Deposition testimony about travel records trip to Amman
- N: Management representation letters